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DIRECTORATE OF INTELLIGENCE

Intelligence Memorandum

Italy's Declining Strength In Foreign Markets

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
March 1972

INTELLIGENCE MEMORANDUM

ITALY'S DECLINING STRENGTH IN FOREIGN MARKETS

Introduction

1. Italy's postwar economic growth has been heavily dependent on rapid export expansion. Since late 1969, however, domestic supply restraints and weaker foreign demand have retarded export growth and contributed to the economic slowdown. Moreover, despite the small global devaluation of the lira in the 18 December international monetary settlement, export growth is unlikely to improve substantially over the next year or so. Weak foreign demand and poor profit expectations in the export sector are helping to prolong Italy's current economic malaise. For the first time in 20 years, the export sector is proving no more than a barely adequate prop for production, and Italy must rely on domestic demand to pull out of an economic downswing.

2. This memorandum briefly compares Italian export growth in the past two years with that in the 1960s and analyses the reasons for the decline in the growth rate. It also assesses the factors affecting Italy's short-term export growth prospects. Finally, it discusses some of the essentials for a return to more dynamic export growth.

Discussion

Exports and Economic Growth

3. Postwar Italian economic growth has been closely linked to strong export expansion. During the 1960s, foreign demand was the fastest growing component of overall demand. In real terms, exports rose twice as rapidly as either domestic private consumption or gross investment. Moreover,

Note: This memorandum was prepared by the Office of Economic Research and coordinated within the Directorate of Intelligence.

vigorous export expansion outpaced substantial import gains and contributed to a generally strong international payments position.

4. The burgeoning Italian manufacturing industry, in particular, increasingly depends on foreign markets. More than 20% of manufacturing output was sold abroad in the latter 1960s (see Table 1), about double the share at the end of the 1950s. A substantial number of industries export more than one-fourth of their total output. With few exceptions, the fastest growing industries in the 1960s were those that substantially increased their share of export production. Clothing, shoe, and leather production and machinery manufacturing, for instance, experienced above-average output growth and considerably increased the share of exports in total sales. Conversely, those industries oriented primarily to the domestic market (foodstuffs and beverages) or experiencing declining export growth (textiles) were among the most sluggish.

5. Exports have also played an important role in a cyclical context. Recoveries from economic slowdowns have usually been export-led. When domestic demand faltered in 1964, producers concentrated on foreign sales. Although Italian unit labor costs had risen steeply relative to those abroad (see Figure 1), export prices rose only slightly. Manufacturers cut profit margins on exports to maintain foreign markets and raised domestic prices in an effort to maintain overall profit margins (see Figure 2). Thus, Italy was able to boost export volume by 15% and 23% in 1964 and 1965, respectively (compared with only 8% and 11% in the two previous years), and to avert a decline in output and contain the rise in unemployment. By the end of 1965, as cost pressures eased and profit expectations improved, foreign demand was strong enough to stimulate investment recovery.

Export Performance to Date

6. Until very recently, Italian export performance was exceptional. During the 1960s, average annual growth rates of more than 16% in export value and more than 14% in volume gave Italy the best export growth record in Western Europe. Italy, dubbed the "Japan of the West," became internationally famous for typewriters, cars, and refrigerators, as well as for colorful and exquisite fashion creations – all in strong demand during a decade of rapidly rising world incomes. As Italy's renown as a competitively priced producer of many quality items spread and firmed, the country increased its share in exports by members of the Organization of Economic Cooperation and Development (OECD) more than any other country except Japan (see Table 2). Italy's share among major industrial countries in manufactured goods exports recorded an especially impressive increase over the decade (see Table 3).

Table 1

Italy: Gross Output and Exports, by Branch of Manufacturing

Manufacturing Branch	1959			1965			1968		
	Million US $			Million US $			Million US $		
	Gross Output	Exports	Exports as a Percent of Gross Output	Gross Output	Exports	Exports as a Percent of Gross Output	Gross Output a/	Exports	Exports as a Percent of Gross Output
Foodstuffs	4,366	166	3.8	6,528	264	4.0	7,640	322	4.2
Beverages	243	41	16.9	471	76	16.1	540	95	17.6
Tobacco	144	1	0.7	230	1	0.4	250	1	0.4
Textiles	1,445	409	28.3	2,290	884	38.6	2,700	1,188	44.0
Clothing, shoes, and leather	1,579	160	10.1	2,802	479	17.1	3,840	798	20.8
Furniture and wood	768	31	4.0	1,258	96	7.6	1,620	153	9.4
Metals	1,299	188	14.5	2,248	504	22.4	3,060	614	20.1
Machinery and metal products	2,944	465	15.8	4,939	1,716	34.7	6,770	2,753	40.7
Vehicles	1,576	402	25.5	2,550	791	31.0	3,320	1,236	37.2
Stone, clay, and glass	938	59	6.3	1,574	199	12.6	2,170	300	13.8
Chemicals and synthetic fibres	1,853	238	12.8	3,267	677	20.7	4,570	868	19.0
Petroleum and coal derivatives	838	207	24.7	1,559	414	26.6	2,100	631	30.0
Rubber	250	27	10.8	494	100	20.2	600	140	23.3
Paper	405	13	3.2	686	50	7.3	940	88	9.4
Films and printed materials	576	15	2.6	1,045	62	5.9	2,110	420	19.9
Other	381	77	20.2	460	264	57.4			
Total	*19,605*	*2,499*	*12.7*	*32,401*	*6,577*	*20.3*	*42,230*	*9,607*	*22.7*

a. Gross output for 1968 was estimated by applying industrial production indices, adjusted for price increases or decreases, to 1965 output data with the exceptions of clothing, shoes, and leather; films and printed materials; and other categories for which corresponding production indices were not available. In these cases, it was assumed that the respective gross output to value added ratios were constant, and thus growth was the same for output as for value added. Gross output data represent production at factor cost obtained from 1959 and 1965 input-output tables.

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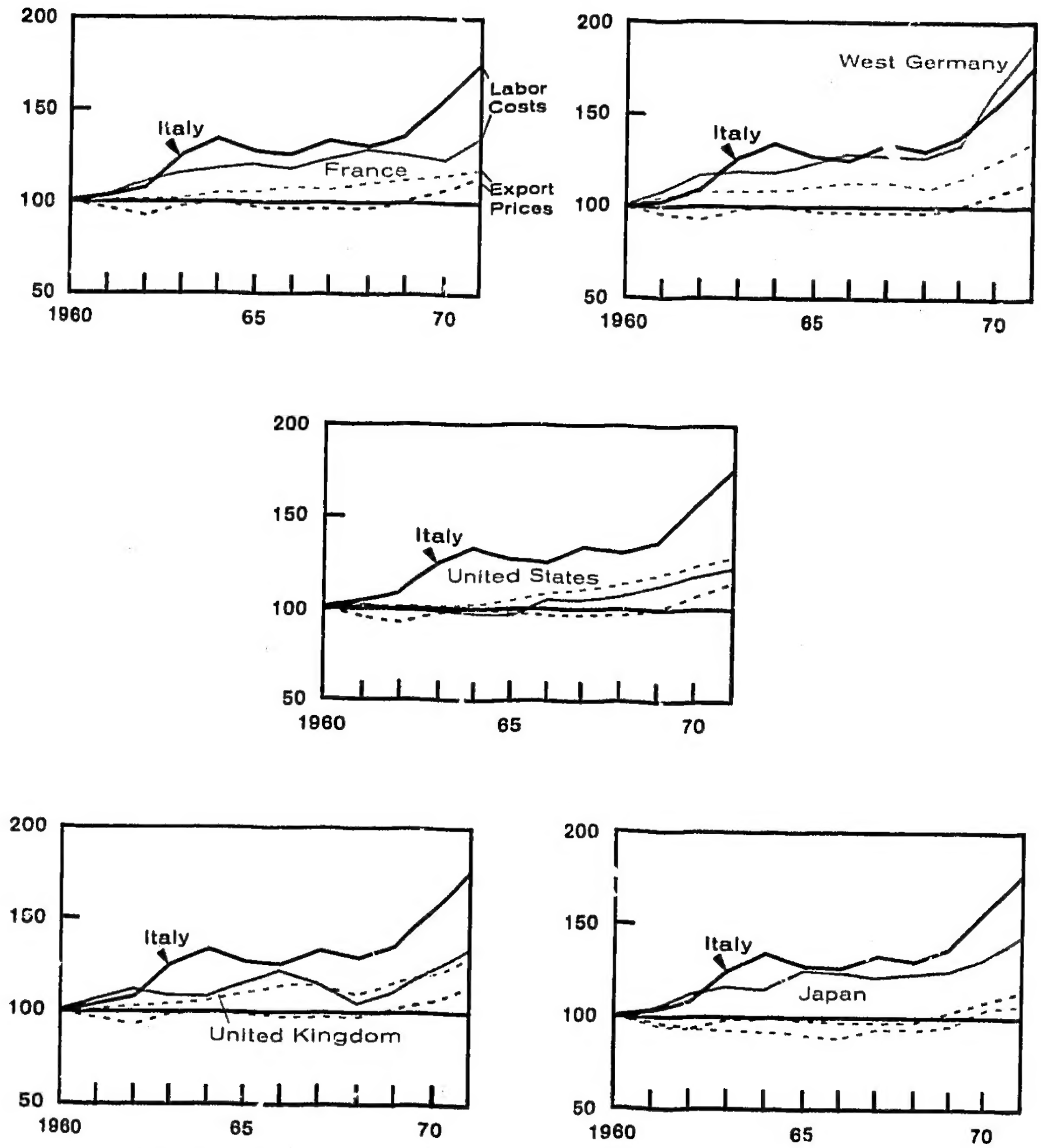
Comparative Trends in Unit Labor Cost and Export Prices in Manufacturing*

Figure 1

(1960=100)



*Based on values in US dollars.

Note: 1971 is estimated.

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Table 2

Changes in OECD Export Market Shares a/

Percent

Country	Annual Average 1968-69 over 1960-61	1970 over 1969	1971 over 1970	1st Half 1972 over 1st Half 1971 b/
Italy	+4.0	-4.1	-0.8	-0.5
France	+0.8	+0.9	+3.5	+4.0
West Germany	+0.8	-0.5	+3.8	0
Netherlands	+0.7	+0.7	+3.2	-2.0
United Kingdom	-3.3	-4.8	+1.0	+1.0
United States	-1.6	+0.2	-5.8	-5.0
Japan	+7.6	+8.5	+10.0	+5.5

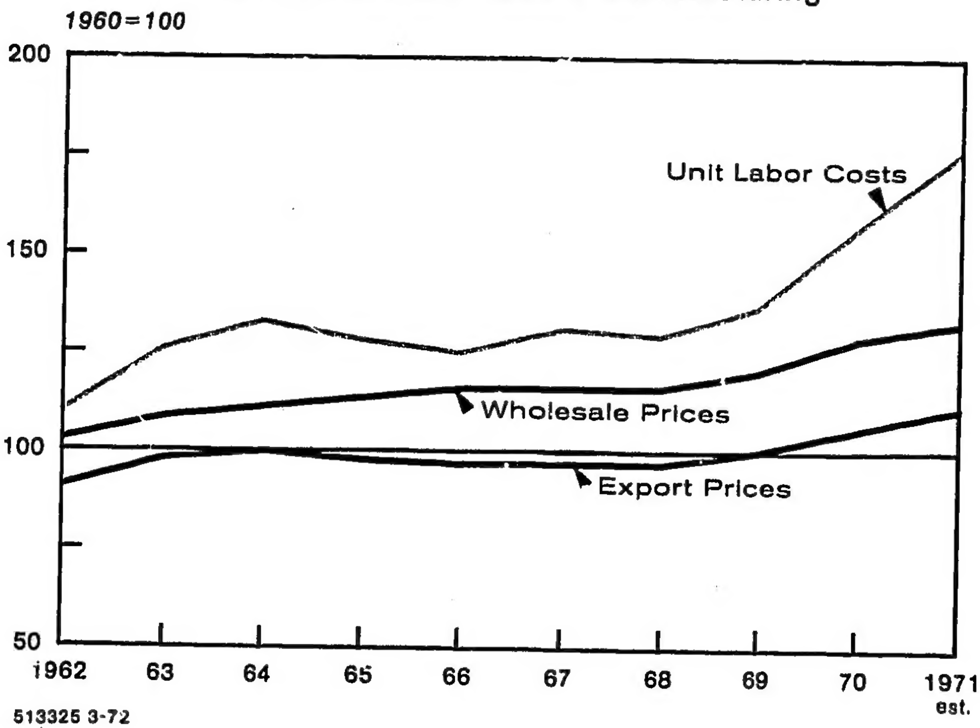
a. The difference between the rate of growth which would occur in a country's export if it exactly maintained its share in total OECD exports to each market and the actual rate of export growth.
b. Forecast.

7. During the 1960s, exports to the other European Community (EC) countries grew most rapidly, reflecting the gradual elimination of intra-area tariffs. Italy increased its sales to France by almost 25% annually and about tripled its share of the French import market. Even below-average Italian export growth rates in the 1960s of 14% and 9% to the United States and the United Kingdom, respectively, were sufficient to boost Italy's share of both countries' total imports, as shown below in percent:

Country	Annual Average 1958-59	Annual Average 1968-69	1970
France	2.9	9.8	9.2
West Germany	5.8	9.8	9.9
Belgium-Luxembourg	2.3	4.2	3.8
Netherlands	1.8	4.5	4.3
United Kingdom	2.2	2.8	2.8
United States	2.3	3.3	3.3

Figure 2

Italy: Unit Labor Costs, Export Prices, and Wholesale Prices in Manufacturing



8. Export performance has deteriorated somewhat since late 1969. Over the past two years, the value of exports has risen an average of only 13% a year. The slowdown was even more marked in terms of export volume, which grew only about 6% annually. As a result, Italy's share of world exports of manufactures declined after the third quarter of 1969 (see Table 3), and its share of total OECD exports fell in both 1970 and 1971. West Germany was the only major country during this period where Italy increased its share of the import market. Elsewhere, Italy's share of total imports either stagnated (as in the case of the United States) or deteriorated (as in the case of France).

Roots of the Problem

9. A wide variety of factors, many of which are related to the domestic labor situation, are responsible for the comparatively poor performance of Italian exports since 1969. Strikes and increased absenteeism have reduced output and export growth directly and at the same time contributed to increased production costs, impairing Italy's international

Table 3

Exports of Manufactures a/ of Selected OECD Countries

Seasonally Adjusted Quarterly Rates

	Value (Billion US $)	Percent of Total						
		Italy	United States b/	United Kingdom c/	West Germany	France	Japan	Others d/
Average 1956-68	10.2	3.8	24.8	18.1	17.6	8.2	5.9	21.6
Average 1966-68	25.6	7.0	20.3	12.1	19.5	8.4	10.1	22.6
1969								
1st quarter	30.7	7.7	18.2	11.3	19.2	8.4	11.5	23.7
2nd quarter	33.4	7.7	19.6	11.0	19.4	8.5	10.9	22.9
3rd quarter	34.5	7.4	19.7	11.5	19.3	7.8	11.2	23.1
4th quarter	35.5	6.4	19.6	11.3	19.2	8.2	11.1	24.2
1970								
1st quarter	36.8	6.9	13.5	11.2	19.5	8.2	11.7	23.0
2nd quarter	38.8	7.3	18.7	10.8	19.7	8.9	11.3	23.3
3rd quarter	38.9	7.4	18.6	10.2	20.0	8.6	11.7	23.5
4th quarter	40.1	7.1	17.7	11.2	20.2	8.8	11.8	23.2
1971								
1st quarter	41.4	7.0	18.3	10.4	20.0	8.6	12.7	23.0
2nd quarter	42.6	7.1	17.2	11.2	19.7	8.9	12.0	23.9
3rd quarter	45.2	7.4	18.3	10.8	20.1	8.2	12.4	22.8

a. Manufactures are defined to include SITC categories 5-8.
b. Excluding special export categories.
c. Excluding precious stones in 1956-58; thereafter including re-exports.
d. Belgium-Luxembourg, Canada, Netherlands, Sweden, and Switzerland.

competitive position. A new "visa" system for important leather shoe exports and financing difficulties also have contributed to a decline in the export growth rate. Demand in major markets was not strong enough to offset these factors.

Strikes and Related Labor Problems

10. Supply problems generated by widespread local labor unrest contributed greatly to the weakness in export performance. Since the third quarter of 1969, Italy has suffered from an abnormally high incidence of strikes, which has reduced the growth of output and exports. In comparison with an annual average strike loss of 4.6 hours per employee in 1960-68, a record of 15.8 hours were lost in 1969 and an average of about 7 hours in 1970 and 1971. In addition to the immediate problems attending the 1969 renegotiation of nationwide labor contracts, the strikes reflect newer phenomena of a more permanent nature. Unions are increasingly bargaining annually for more benefits at the plant level in addition to the industry-wide negotiations that fall due roughly every three years. Besides impeding industry's adjustments to higher labor costs, the increased frequency of negotiations involves a higher strike incidence. Moreover, Italian labor unions increasingly have engaged in activities related to social reform. Over the past few years, the unions staged a large number of nationwide and regional general strikes to protest a lack of low-income housing and health facilities. More recently, they have struck to protest the government's failure to improve public transportation, to provide better employment, or to take effective measures to control inflation.

11. These strikes have also damaged Italy's ability to meet delivery schedules – an important consideration for foreign buyers. While comparative delivery data are not available, Italy's high strike incidence, combined with a tradition in many Italian industries of keeping inventories low, suggests that Italian exporters were at a strong competitive disadvantage in terms of their ability to deliver the goods. The ratio of man-days lost because of strikes in Italy relative to its competitors worsened notably after 1968 (see Table 4). Partial data for 1971 suggest no substantial change from the 1970 pattern. The Italian strikes also received wide press coverage abroad, and this publicity undoubtedly had an adverse psychological effect on potential foreign buyers.

12. Increased employee absenteeism in industry has imposed some direct output restraints, particularly among assembly-line workers in large factories. At FIAT plants, for example, absenteeism rose from about 4% to 5% a day in 1965 to more than 12% a day by late 1970. Increased use of sick leave reflects both improved benefits under new labor contracts and looser controls over sick leave procedures contained in a 1970 Workers' Statute.

Table 4

Man-Days Lost per Employee in Italy as a Result of Strikes (Expressed as a Multiple of Those in Other OECD Countries) a/

Country	Annual Average 1960-68	1969	1970
France	4	19	12
West Germany	86	218	362
United Kingdom	6	9	2
Netherlands	86	436	36
United States	2	4	1
Japan	8	28	13

a. Data are adjusted for variations in length of workweek among countries.

13. The effects of strikes and absenteeism on output and exports are clearly illustrated by the plight of the important Italian motor vehicles industry (which accounts for about 1% of GNP directly and for more than 6% of exports). FIAT, which produces more than 90% of Italian-made cars, buses, and trucks lost an exceptionally high 35 million man-hours of work to strikes and absenteeism in 1970; Alfa Romeo, the major state-owned automobile producer, also has been hard hit. Consequently, the growth of both motor vehicle output and exports has slowed since 1968, as shown below:

	Percent			
	Average Annual 1960-68	1969	1970	1971
Production	+14.3	-4.1	+16.2	-2.0
Export volume	+11.5	+11.0	+3.3	+1.4

Despite the strong recovery following the decline in 1969, motor vehicle production in 1970 was only slightly higher than in 1968 and fell short of forecasts. FIAT attributes a 10% output loss in 1970 to labor difficulties.

14. Other labor-related restraints on output growth have arisen over the past year or two. Most labor contracts negotiated since 1969 provide for a gradual reduction of the workweek from 44 to 40 hours. The unions also succeeded in placing limitations on permissible overtime -- a ploy to increase employment. Rather than provide additional jobs, however, the net effect was to reduce output. With many employers unwilling to increase employment in view of rapidly rising labor costs, generally weak demand, and legal difficulties in dismissing redundant workers, these measures cut capacity utilization. Labor difficulties, moreover, have contributed to weak investment demand. A decline in real investment growth in 1971 has kept expansion of new capacity to a maximum of about 3%, a sharp contrast to average annual increases of close to 8% in 1966-70.

15. Labor difficulties also have greatly contributed to increased costs. Italy's price advantage over foreign competitors traditionally has been based primarily on lower unit labor costs. But this advantage has been eroded seriously since 1968. Indeed, up to 1961, rapid increases in labor productivity -- in large part the result of imported technology -- contributed to generally declining unit labor costs. This situation was duplicated only by France and Japan among major industrial countries. Italian cost/price trends turned generally less favorable after 1961 and have become particularly adverse since 1969 (see Figure 1). Frequent production disruptions and low plant utilization rates reduced the growth of labor productivity while wage rates were climbing rapidly -- basic minimum wages in manufacturing rose 22% in 1970 and about 14% in 1971. As a result, unit labor costs rose sharply, and Italy's cost position deteriorated relative to that in the other major industrial countries, except for West Germany.

16. Under the impact of rising labor costs and increasing prices for imported raw materials, Italy's unit export values began to climb in 1969. The extent of the increase, however, was modest in comparison with that of the costs. As suggested by the relative movement of wholesale and export prices (unit export values), producers cut profit margins on exports to maintain their foreign market position and attempted to make up losses on the home front (see Figure 2). When domestic demand weakened sharply in 1971, curtailing substantial local price hikes and forcing greater export price increases, inflation in Italy's principal foreign markets, and generally favorable parity changes (particularly the German revaluations since 1969 and favorable floats relative to most industrial countries after August 1971) combined to preclude a sharp decline in price competitiveness.

Miscellaneous Factors

17. Suspension of dollar convertibility and subsequent currency floats, as well as the 10% US import surcharge, had little overall impact on Italy's

already weakened competitive position. Exchange rate movements between 15 August and 18 December slightly favored Italy, with the lira experiencing a de facto global devaluation of about 2% during most of the period. Indeed, the year-to-year growth rate of Italian exports for the August-November period in 1971 was slightly higher than that for the first seven-month period of the year. Growth of exports to the United States did decline sharply in the fall of 1971, but this probably was attributable more to the prolonged East Coast dock strike than to the import surcharge.

18. A specific constraint was imposed on exports of leather shoes in 1971. Nearly half of these exports (44% in 1970, representing 2% of total Italian export value) go to the United States. Fearing protectionist US sentiments might lead to import quotas, the Italian Government imposed a statistical monitoring system on shoe exports. Exporters had to apply to local Chambers of Commerce for export "visas." While shoe exports to the United States were not legally restrained, the visa system, along with the government's publicly expressed hopes that shoe exports to the United States would remain at 1970 levels, probably restrained overall growth of shoe exports. At least it enabled the government to monitor export levels and take appropriate action. The implied threat of the new monitoring system, together with an increase in export prices, contributed to an 11% decline in the volume of shoe exports to the United States during the first 10 months of 1971. In 1970, both value and volume of shoe exports to the United States had risen about 30%, close to the average of the 1960s.

19. While export financing arrangements are difficult to compare, Italy's competitive position in this field probably has deteriorated also. Italy offers interest rate subsidies on long-term and medium-term credits. Although partly offset by equivalent practices in other countries, notably the United Kingdom and France, these subsidies permitted Italian exporters to maintain equal or lower financing terms than those of major foreign competitors. However, in 1970, **Mediocredito Centrale**, the official institution that offers refinancing of up to 85% of export credits at subsidized rates, increased its minimum subsidized interest rates. In 1968-69 the market rate of interest for prime borrowers had been 8.25% and the subsidized rate 5.9%; by the fall of 1970 the respective rates were 10.25% and 6.5%.(1)

20. With market interest rates up, demand for subsidized credits increased substantially in 1970-71. At the same time, facing a strong demand for increasing expenditures for social reforms, the government did not increase funds for interest subsidies and indeed cut budget ceilings on state

1. If a project involves special political-economic interests – such as the FIAT plant in the USSR – the subsidy can be increased. This would lower the current subsidized rate to 6%.

export insurance. For some time, funds available for subsidies were nearly exhausted, virtually drying up new medium-term and long-term export credits. In August 1971, new funds were appropriated by the government, temporarily alleviating the situation.

Short-Term Prospects

21. A number of factors suggest that export performance over the next year or so is likely to follow trends established in 1970-71 rather than revert to the more buoyant growth patterns of the 1960s. Unit labor costs will rise further and considerable strike activity probably will continue, imposing restraints on both output and export growth. Subsidized export credits will remain scarce. The approaching market saturation for several important products as well as slower income growth in important foreign markets may also adversely affect the export growth rate. At the same time, however, the net global devaluation of the lira in December 1971, mutual tariff reductions within the expanded EC starting next year, and anticipated improvements in the quality of exports and in marketing techniques all should act to maintain export growth rates at approximately the level of the past two years.

22. The large increases in unit labor costs in 1970-71 are not yet fully reflected in export prices, and further increases in unit labor costs should occur this year as wages continue to grow considerably. Production disruptions from strikes probably will remain higher than the average in the 1960s, cutting into output and productivity growth. The government has satisfied union demands for several social reforms, but others, including improvement of health and public transportation facilities, remain unfulfilled. Moreover, in the fall of 1972, contract renegotiations affecting 4.5 million workers come due once again.

23. Funds for subsidizing export credits will continue to be scarce. Despite additional allocations in August 1971, current budgetary allotments provide decreasing funds for export credit subsidies over the next few years, as indicated below in million lira:

1969	18,925
1970	18,925
1971	23,425
1972	18,425
1973	13,425

An injection of additional subsidy funds in 1971 alleviated the problem then facing exporters, but substantially more funds are needed to support export growth during 1972 and 1973.

24. Increasing market saturation in several important product areas will tend to slow export growth. Domestic appliances, for instance, go predominantly to Western Europe. By producing a low-priced product with an expensive-looking exterior, Italian appliance manufacturers have captured most of the West European market for such appliances and increased their export value an average of 30% a year in the past decade. However, at the beginning of the 1970s, 84% of European households had refrigerators, 66% had washing machines, and 83% had cooking ranges, whereas ten years ago only 36% had refrigerators and 10% had washing machines. To make matters worse, Italy now faces increased competition from lower priced Spanish and Yugoslav products. Thus the Italian appliance industry is becoming increasingly dependent on replacement orders. Despite the disappearance of virgin territory, Italian exporters should be able to continue to increase sales. Qualitative improvements (that is, adding a freezer component to refrigerators), product diversification (making more freezers and dishwashers), tariff reductions in the enlarged EC, and expanded foreign links (mergers with non-Italian firms to enable marketing of Italian goods under foreign brand names) all promise to support export expansion. It is unlikely, however, that the exceptionally high past growth rates can be maintained.

25. As markets for first-time purchases become more saturated, exports become more vulnerable to income changes. A consumer is more likely to delay replacing his old car if his employment situation looks questionable than to delay his first purchase. With few exceptions, income expansion in Italy's major markets was very favorable to import growth in the 1960s and was still so for the most part during 1970-71. The outlook for 1972, however, is for much slower growth in Italy's major market, West Germany, and generally slower growth in other EC countries as well (see Table 5). While this will tend to slow overall export growth, exports supplying replacement needs and consumer durables, in general, probably will feel the pinch more than others.

26. Italian automobile exporters are facing increasing market saturation, indicated by a slowing in new automobile registrations in Europe over the past few years. Indeed, the best automobile market in Western Europe at present is Italy, where registration growth still substantially exceeds overall economic growth. Italian exporters, then, are increasingly servicing replacement needs abroad and facing stiffer competition – especially from West Germany – for a slower growing market.

Table 5

Economic Growth in Major Foreign Markets

Percent

Country	Average Annual Rate of Growth of Real GNP a/ 1968-69 Average over 1958-59 Average	1970	1971 b/	1972 b/	Share of Italian Exports, 1971
West Germany	5.1	5.4	3.6	1.0	22.7
France	5.7	5.9	3.5	5.0 to 5.5	13.5
Netherlands	5.3	5.6	5.0	3.0	4.6
Belgium	4.7	6.1	3.8	3.5	
Luxembourg	3.1	3.5	1.0	1.0 to 1.5	3.8
United States	2.2	-0.6	2.7	4.5 to 6.0	9.8
United Kingdom	3.1	2.2	1.4	3.5 to 4.5	3.9
Switzerland	4.5	4.5	4.0	3.0 to 3.5	4.7

a. Data for France, United Kingdom, and Switzerland are for gross domestic product.
b. Estimated.

27. The recent international monetary settlement resulted in a global devaluation of the lira of about 1%. In terms of the dollar, the lira was revalued by 7.48% (central rate). The adverse effect of this revaluation on Italian exports to the United States is less, however, than the combined impact of the 10% US imports surcharge[2] and the 2% **de facto** revaluation of the lira relative to the dollar that prevailed through most of the 15 August-18 December 1971 period. More importantly, Italy's December revaluation relative to the dollar was less than that of most of its major competitors. While the price of Italian products in the United States will now be higher than it was prior to August 1971. Italy's competitive position in the US market will be somewhat improved relative to that of the other major foreign suppliers. This should enable Italy to maintain its share of the US import market. In third country markets, Italy's competitive position weakened relative to that of the United States, but its position relative to other competitors, particularly West Germany and Japan, strengthened. Of special importance is the fact that within the EC, which accounts for 45% of Italian exports, the net devaluation of the lira was about 3.5%. The mild stimulus to exports resulting from the small devaluation, however, will be at least partly offset by the increased costs of imported raw materials, particularly fuels, and of many semimanufactures.

28. In the near term, the adverse export growth trend should not impair Italy's balance-of-payments position. Because of the weakness of domestic demand during the past two years, imports have grown more slowly than exports. As a result, Italy's trade deficit (f.o.b./c.i.f.) was actually cut in half in 1971. With the chances for any strong revival of domestic demand rather slim for the next 12-18 months, export growth even at the currently low rate will be sufficient to keep Italy's external balance in the black.

Longer Term Perspectives

29. With competition in world trade becoming stiffer, and export growth badly needed to stimulate the domestic economy, new approaches to export expansion are being tried. Perhaps more importantly, Italians are giving more attention to the importance of diversifying the industrial product mix to reduce dependence on exports of nondurable and relatively unsophisticated durable consumer goods Today's major Italian export commodities -- including shoes and, increasingly, low-cost electrical appliances -- face growing competition from semi-industrialized suppliers such as Spain, Yugoslavia, Greece, and Hong Kong, which enjoy substantially lower labor costs. Italian manufacturers will probably concentrate more on

2. The full 10% import surcharge affected about one-half of Italian exports to the United States.

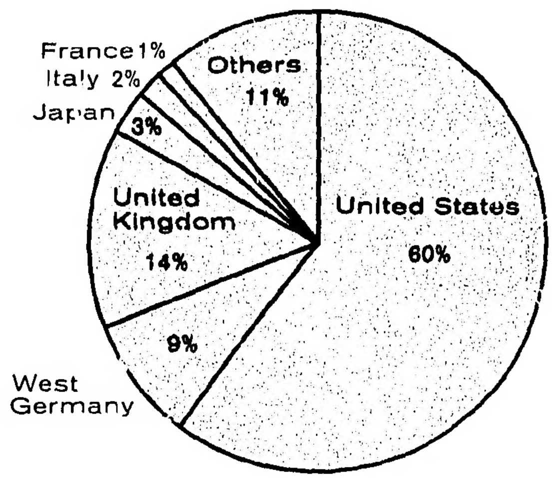
exports of machinery, equipment, and sophisticated consumer durables, carving out new foreign markets through product specialization.

30. Qualitative improvement of export products already is under way, especially among manufacturers of electrical appliances. These efforts probably will intensify and spread to other industries. At the same time, attempts to outmaneuver the competition through increasing product differentiation -- as for example, FIAT's production of a wider range of cars -- probably will become more common.

31. Diversification and qualitative improvements in the Italian product mix will depend heavily on up-to-date technology. Italy's own research and

Figure 3

OECD: Origin of Major Technological Innovations Since World War II*



*Percentage shares of 139 major technological innovations originating in the OECD member countries.

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development effort, however, traditionally has been small, and the country has ranked next to last among the major contributors of technological innovations during the postwar period (see Figure 3). Imported technology, combined with low-cost labor and original styling, in the past has enabled Italian manufacturers to compete effectively in exporting advanced industrial products. By lowering the cost of patents, know-how, and capital equipment from the United States, Italy's principal supplier, the lira revaluation relative to the dollar could enhance the technical capability and competitive position of Italian industry.

32. Increasing competitive pressures also highlight the problem of fragmentation in the Italian foreign trade sector. Italy now has nearly 40,000 exporters, most of whom export less than $200,000 of merchandise annually. To improve the financial strength of Italy's exporters and enhance their capabilities in market research and sales promotion, Italy's Foreign Trade Minister Zagari has recommended the establishment of foreign trade consortiums in which a number of smaller exporters would pool their efforts.

33. Finally, stepped-up government sales promotion activities in support of Italian industry are likely. The large-scale advertising campaign conducted in the United States in 1971 by the official Italian Institute for Foreign Trade was an initial move in this direction. Further efforts along this line, carefully patterned to the needs and tastes of different markets, are likely to follow.

Conclusions

34. The sharp decline in Italy's average annual export growth rate, from 14% during the 1960s to 6% in 1970-71 (in volume terms), is worrysome primarily because the Italian economy has come to depend on the rapid expansion of exports to support aggregate economic growth. Thus, the slowdown in export growth and the partly related decline in domestic investment have contributed significantly to the precipitate drop in aggregate economic growth from 6% annually during the 1960s to a postwar low of 1% in 1971. In the absence of signs suggesting a substantial upturn of export demand in 1972, the Italian economic malaise is expected to continue for the next 12 months. In the longer run, a return to the rapid economic growth that alone can provide the jobs, goods, services, and social reforms increasingly required to ensure domestic political stability is unlikely without renewed export dynamism.